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In the

Supreme Court of the United States

OCTOBER TERM, 1970.

No. 1210

TECHNICAL DEVELOPMENT CORPORATION and FRANKLIN F. OFFNER,

Petitioners,

vs.

BECKMAN INSTRUMENTS, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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Petitioners, Technical Development Corporation and Franklin F. Offner, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered September 4, 1970.

OPINIONS BELOW.

The opinion of the District Court is included in the Appendix (A, pp. 1a-4a). The opinion of the United States Court of Appeals for the Seventh Circuit is included in the Appendix (A, pp. 5a-17a). The opinion of the District

Court is not reported. The opinion of the Court of Appeals is reported at 167 USPQ 10 and .... F.2d .... (7th Cir. 1970).

JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on September 4, 1970. Petitioners filed a timely petition for rehearing which was denied on October 13, 1970.

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTION PRESENTED

Whether this Court's decision in *Lear, Inc.* v. *Adkins*, 395 U.S. 653 (1969), permitting a non-exclusive licensee to challenge the validity of a licensed patent, should be extended to an exclusive licensee.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Constitution of The United States Art. 1, Sec. 8. The Congress shall have power . . . To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.

United States Code, Title 35 §282. A patent shall be presumed valid . . . .

STATEMENT OF THE CASE

Respondent, Beckman Instruments, Inc. ("Beckman"), sued Petitioners, Technical Development Corporation ("TDC") and Franklin F. Offner ("Offner"), in the United States District Court for the Northern District of Illinois, Eastern Division, for a declaratory judgment that, among

other things, United States Patent No. 3,225,305 ("'305 Patent") is invalid, uninfringed and unenforceable. Jurisdiction of the District Court was invoked because a question arises under the Patent Laws of the United States and because of diversity of citizenship.

TDC is the exclusive licensee under certain patents and patent applications owned by Offner (App. I, p. 2).* Pursuant to a certain agreement ("Agreement") dated August 8, 1961, TDC granted Beckman an exclusive sublicense under certain of Offner's patents and applications (App. I, pp. 9-21).

The Agreement was entered into by Beckman and TDC as a companion transaction to Beckman's purchase of the assets and business of Offner Electronics, Inc., a company formed by Offner (App. III, p. 255). The Agreement gave Beckman entree into certain fields of biomedical electronics (App. I, p. 196). Under the Agreement, TDC grants Beckman an exclusive sublicense covering at its inception, twenty-one patents and applications (App. I, p. 21). In addition, the exclusive sublicense covers certain applications filed by Offner after the date of the Agreement and the patents issued thereon (App. I, p. 10).

The Agreement requires Beckman to pay TDC royalties measured by varying percentages of the gross sales price of certain apparatus sold by Beckman (App. I, pp. 12-13). The Agreement does not provide for a minimum royalty payment.

Prior to execution of the Agreement, Beckman submitted a draft of the Agreement to TDC containing a clause

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* "App." refers to the Appendix before the Court of Appeals. "A" refers to the Appendix accompanying this Petition.

which would have explicitly prohibited Beckman from contesting the validity of sublicensed patents (App. III, p. 279). TDC rejected the clause because it desired to rely on the general legal principle of licensee estoppel (App. III, p. 219).

A controversy arose between the parties over Beckman's refusal to pay TDC royalties, pursuant to the Agreement, on Beckman's sale of apparatus covered by the '305 Patent. Both the application for the '305 Patent and the '305 Patent itself were sublicensed to Beckman under the Agreement (App. I, p. 166). The application for the '305 Patent was filed on January 3, 1962, after the date the Agreement was entered into (App. I, p. 73). On December 21, 1965, the '305 Patent was issued.

In response to a motion for summary judgment filed by TDC and Offner, the District Court ruled that Beckman was estopped from challenging the validity of the '305 Patent (A, pp. 1a-4a). Beckman appealed this ruling and other rulings of the District Court. The other rulings are not relevant for purposes of this Petition. Shortly after the notice of appeal to the Court of Appeals was filed, this Court announced its decision in *Lear, Inc.* v. *Adkins*, 395 U.S. 653 (1969). The Court of Appeals, relying on *Lear*, reversed that portion of the judgment of the District Court which estopped Beckman from challenging the validity of the '305 Patent (A, pp. 7a-10a).

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals, extending *Lear, Inc.* v. *Adkins*, 395 U.S. 653 (1969), to an *exclusive* licensee, will have an immediate and pernicious effect on the patent system. Instead of promoting the public interest — the goal of this Court in *Lear* — the extension

of *Lear* to an exclusive licensee will have a detrimental effect on the public interest. Although the Court of Appeals recognized the importance of the issue raised by this Petition (A, p. 5a), it held that it was "not convinced that the Supreme Court would rule differently" in a case involving an exclusive license (A, p. 8a). The effect on the public interest of permitting an exclusive licensee to challenge the validity of a licensed patent was neither considered, briefed nor decided in *Lear*. Accordingly, this important question of federal law should now be decided by this Court.

In *Lear*, this Court permitted a non-exclusive licensee to attack the validity of a licensed patent in order to encourage the "full and free competition in the use of ideas which are in reality a part of the public domain." (p. 670) The Court reasoned that "Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery." (p. 670) If they are "muzzled", the Court continued, the public may be required to pay "tribute" for an idea in the public domain. Balancing the competing demands of private contract law, on the one hand, and the public interest in the free use of ideas in the public domain, on the other hand, this Court concluded that the requirements of private contract law were not compelling and "must give way before the demands of the public interest." (p. 670)

Both *Lear* and *Automatic Mfg. Co.* v. *Hazeltine Research, Inc.*, 339 U.S. 827 (1950), the case overruled in part by *Lear*, involved non-exclusive licenses as contrasted to the exclusive license involved in the instant case.* In

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* In *Lear*, the license was initially an exclusive license. Prior to the filing of the suit, it was automatically con-

extending *Lear* to the instant case, the Court of Appeals failed to realize the substantial differences between an exclusive and a non-exclusive license. In the case of an exclusive license

> A. the harm the public will suffer by permitting the licensee to challenge validity will far outweigh any benefit which it may derive; and
>
> B. the demands of private contract law supporting the licensee estoppel doctrine are far more compelling than in the case of a non-exclusive license.

Thus, in the case of an exclusive license, the requirements of private contract law and the demands of the public interest do not "compete." Both are in harmony and both compel the retention of the estoppel doctrine.

A. The Harm The Public Will Suffer By Permitting An Exclusive Licensee To Challenge Validity Will Far Outweigh Any Benefits Which It May Derive.

Permitting an exclusive licensee to challenge the validity of a licensed patent will serve as a deterrent to the advancement of our technological development through the cooperative efforts of the independent inventor and the large corporate licensee. This adverse effect will far outweigh any benefits the public may derive by permitting an exclusive licensee to challenge the validity of a licensed patent.

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* Continued.
verted, under the terms of the license agreement, into a non-exclusive license. See Opinion of the District Court of Appeals, 52 Cal. Rptr. 795, 806 (1966) and Brief for Respondent in Supreme Court, p. 17.

Despite the trend toward "bigness" in our society, independent inventors, like Offner, play a vital role in our technological development. Jewkes, The Sources of Invention (Macmillan & Co., Ltd. 1958), pp. 97-98; and Ruben, Opportunities Afforded an Independent Inventor by the Patent System, 10 Idea 116, 120 (1966-67). Indeed, the importance of Offner's role in technological development has received judicial recognition. In a case involving other Offner inventions licensed to United Aircraft Corporation, the Tax Court stated:

> "It is clear that petitioner's [Offner Products Corporation] contribution to the defense effort was historic and immense. Ten years of effort went into the development and perfection of the electronic jet engine fuel control. It constituted a 'breakthrough' in the known art and was a significant gateway in the history of electronic gas turbine controls. It gave the United States a decided edge over its international rivals. It saved the Government millions of dollars in money and in time. Petitioner's chief executive officer, Offner, cooperated with other contractors and the U.S. armed services in furnishing them advice, assistance and technical guidance." *Offner Products Corporation* v. *Renegotiation Board*, 50 T.C. 856, 864 (1968)

Typically, an independent inventor while he may have valuable ideas, does not have the resources to develop, manufacture and market the inventions embodied in his ideas. Often, as in the above cited case, it is only through cooperative efforts with a large corporate licensee that such ideas can be commercially developed and made available to the public. Commercial development costs alone are usually so high that only big corporations can finance them. *Id.* Jewkes at pp. 197-198; and *Id.* 10 Idea at p. 119. Having incurred a considerable investment

which it desires to protect, the large corporate licensee will normally insist upon an exclusive license.

The great benefit the public has derived from the cooperative efforts of the independent inventor and the large corporate licensee working within the framework of an exclusive licensing arrangement will be placed in jeopardy if exclusive licensees are given the right to challenge the validity of licensed patents and thereby avoid their royalty obligations. Knowing that an attempt may be made to completely disregard his life's work, the independent inventor will be most reluctant to grant any license at all, especially an exclusive license. If an exclusive license is granted, the independent inventor may not have the resources to withstand protracted patent litigation with his licensee. By challenging validity, an exclusive licensee can effectively preclude the inventor from financing the defense of his patent. Cessation of the royalty payments may eliminate the sole source of income of an independent inventor who has granted an exclusive license. The large corporate licensee, being denied the protection of an exclusive license, will naturally be reluctant — to the detriment of the public — to spend the vast sums of money so often required for the development and marketing of new products.

Furthermore, even if the independent inventor were to grant an exclusive license to a licensee who is permitted to challenge validity, his relationship with the licensee would be completely altered — also to the detriment of the public. Instead of the cooperative spirit and the full interchange of information which in the past has contributed so much to the public's benefit, the relationship between the inventor and the exclusive licensee will be converted into one between adversaries. Fearing that

information which he supplies could later be used by his licensee to challenge the validity of his patents, the inventor will make as little disclosure as possible to his licensee. Both parties will be more concerned with protecting their respective positions than maximizing the benefits of the licensed inventions.

The instant case illustrates the benefits derived from the cooperative efforts of the independent inventor and the large corporate licensee. It is an example of our patent system at its best. Pursuant to the Agreement, Beckman is granted an exclusive license under numerous inventions of Offner. By its own admission, Beckman "obtained entree" through the Agreement into the fields of biomedical electronics (App. I, p. 196). It was only with the help of Beckman, a corporate giant with a net worth in excess of sixty million dollars (App. I, p. 219), that wide public distribution of the important ideas embodied in the numerous Offner patents could be obtained.

The mere existence of the right of an exclusive licensee to challenge the validity of its licensed patent will thus, in and of itself, have a pernicious effect on the advancement of technology. If the harmful effect of permitting an exclusive licensee to attack validity is balanced against the benefit which the public might derive therefrom, it will become clear that the public interest will be best served by retaining the licensee estoppel doctrine in a case involving an exclusive license. As will be shown below, in the case of an exclusive license, it is not necessary to permit the licensee to attack validity in order to obtain the benefits of having the licensed patent declared invalid. Furthermore, the public itself may not benefit from an exclusive licensee's successful attack on the validity of a licensed patent.

A non-exclusive licensee does not have a monopoly. Other persons may be licensed to use the ideas covered by the licensed patent. Because of the availability of the license, all those who desire to operate in the field may be licensees under the patent. Thus, there is a great likelihood, as this Court recognized in *Lear*, that "the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery" are licensees (p. 670).

The exclusive licensee, on the other hand, has a monopoly. If any other person desires to use the ideas embodied in the licensed patent, he must challenge the patent's validity either by a declaratory action or by a defense to an infringement suit. Thus, in the case of an exclusive license, there are persons, other than the licensee, who have strong economic incentive to attack validity. Accordingly, it is not necessary to permit an exclusive licensee to attack validity in order to obtain the benefits of having the licensed patent declared invalid.

Even in a higly concentrated or specialized industry, where there may be no other person who desires to use the invention embodied in the licensed patent, the public interest will not be promoted by permitting the exclusive licensee to challenge validity. Since by hypothesis the company holding the exclusive license already has an effective monopoly, it could charge whatever the market will bear, regardless of whether its costs include royalty payments to the inventor. If relieved of royalty payments, the exclusive licensee, because of its monopoly, will have no incentive to lower its price to the public.

Similarly, if an industry is using an invention, but ignoring the patent, the public itself will not receive any

benefit if the exclusive licensee is successful in challenging validity. Since by hypothesis the price to the public has already been set by free competition in the industry, there is no reason to believe that the exclusive licensee would lower its prices if the patent is declared invalid. Thus, the only one to benefit from a declaration of invalidity would be the exclusive licensee itself.

B. The Demands Of Private Contract Law Supporting The Licensee Estoppel Doctrine Are Far More Compelling In The Case Of An Exclusive License Than In The Case Of A Non-Exclusive License.

In entering into an exclusive license, the licensor gives up a valuable right. He is precluded during the term of the license agreement from granting other licenses and making other business arrangements with respect to the licensed patent. As pointed out above (p. 8), his economic ability to defend the validity of his patent against a challenge by his licensee may be seriously prejudiced. The licensor under a non-exclusive license does not, on the other hand, give up this right. He is not precluded from exploiting the use of his invention during the term of the license and therefore his economic ability to defend his patent is not prejudiced.

As contrasted to the inequities suffered by the exclusive licensor, the exclusive licensee, if permitted to challenge validity, is afforded the best of all worlds. It will have the free use of the licensed patent and, in sharp contrast to the non-exclusive licensee, the ability to exclude others from using the challenged patent. An exclusive licensee should not be permitted to take such inherently inconsistent positions. It should not be permitted to retain the benefits of its monopoly — the right to prohibit the licensor from licensing the art to others and the right to exclude others

from using the art* — at the same time that it is contesting the validity of the licensed patent. If an exclusive licensee desires to challenge validity, it should at the very least be required to relinquish its exclusivity. A non-exclusive licensee who is contesting validity is not guilty of taking an inconsistent position. It has no ability to exclude others from using the challenged patent.

The instant case clearly illustrates the inequities of permitting an exclusive licensee to challenge validity. Beckman received everything it bargained for under its exclusive sublicense from TDC. Since the Agreement did not provide to the contrary, there was no warranty given by TDC to Beckman that the '305 Patent — or any of the other sublicensed patents — were in fact valid. Ellis, Patent Licenses §§216 and 225 (3rd ed. 1958); and 4 Walker on Patents §403 (Deller 2d ed. 1965). Beckman received precisely what it was entitled to, namely, a presumption that the '305 Patent is valid. 35 U.S.C. §282. Through the Agreement, it obtained entree into the fields of biomedical electronics. It would violate every principle of equity and fair dealing to allow Beckman to renege in its bargain. Beckman specifically recognized that it was obligated to pay royalties under the Agreement regardless of the validity of any of the sublicensed patents. Prior to the execution of the Agreement, Beckman itself submitted a draft of the Agreement to TDC containing a clause which would have explicitly prohibited Beckman from contesting validity (App. III, p. 279). TDC rejected the clause and advised Beckman that it desired to rely

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* It is, of course, immaterial whether the exclusive licensee, in fact, exercises its right to exclude others from using the art by way of infringement suit. The important point is that the exclusive licensee has the *right* to exclude others.

on the general principles of licensee estoppel (App. III, p. 219).

After the controversy as to the payment of royalties under the '305 Patent arose, TDC offered to convert Beckman's license under the '305 Patent into a non-exclusive license and reduce Beckman's royalty payments (App. III, pp. 225-228). Beckman, however, rejected this proposal, choosing instead to take the inherently inconsistent position of retaining the benefits of its exclusivity — and thereby preventing TDC from licensing others — at the same time that it challenges validity and refuses to pay royalties.

CONCLUSION

From the foregoing, it is clear that the requirements of private contract law and the demands of public policy both favor retention of the licensee estoppel doctrine in the case of an exclusive license. Petitioners therefore respectfully request this Court to grant the Writ of Certiorari.

Respectfully submitted,

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January 11, 1971

APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Beckman Instruments, Inc., a corporation,
Plaintiff,
vs.
Technical Development Corporation, a corporation, and Franklin F. Offner,
Defendants

No. 66 C 1710

MEMORANDUM OPINION

Motion of Defendants for Summary Judgment as to Count I

Plaintiff's complaint was framed in two counts. In Count II, as amended, plaintiff sought a declaration that the sublicense agreement between itself and TDC was unenforceable because it constituted patent misuse on five separate grounds. On January 10, 1969, we granted defendants' motion to dismiss Count II as amended. In the remaining Count I, plaintiff seeks a declaration of invalidity, noninfringement and unenforceability with respect to the 305 patent. Defendants have moved for summary judgment on this count. They seek to show that plaintiff is estopped from challenging the validity of the 305 patent and that they, the defendants, have not misused the 305 patent. If defendants prevail, the parties may proceed with arbitration pursuant to their agreement.

Initially, we recall that on two separate occasions this court has ruled that the 305 patent is a licensed patent right under the sublicense agreement. See Memorandum Opinion dated June 17, 1968, and March 4, 1968. Consequently, there is no real issue as to plaintiff's noninfringe-

ment of the 305 patent. However, in a brief although not by motion, plaintiff has requested that the court reconsider these prior rulings, suggesting that as a result of a deposition examination of defendant Offner, which was conducted subsequent to our two rulings on this matter, a genuine issue of material fact exists as to whether or not the 305 patent is a licensed patent right under the sublicense agreement of August 8, 1961.

The question of whether the 305 patent is a licensed patent right was first submitted to this court by defendant's motion for partial summary judgment, filed on June 27, 1967. Approximately three months were alloted for completion of discovery with respect to that motion. On March 4, 1968, we first held that the 305 patent was a licensed patent right. Plaintiff moved to reconsider that decision, but did not undertake any further discovery. After reviewing another series of extensive briefs, this court, on June 17, 1968, reaffirmed its original conclusion. Only then, approximately two years after the filing of the complaint and one year after the particular issue was raised by motion, did plaintiff undertake the deposition of defendant Offner. The examination ended on September 21, 1968. Over five months more elapsed until plaintiff, in its brief in Opposition to Defendant's Amended Motion for Summary Judgment, issued its second request for reconsideration of the motion.

Plaintiff literally and figuratively has had more than the day in court to which it is entitled.

> "Litigation must end at some point. . . . Our system of jurisprudence contemplates that a party who is dissatisfied with the decision of a trial court may submit the cause to a court of higher jurisdiction for review. Argument and reargument of legal questions by motions repetively presented to the trial court can serve no purpose other than to burden the judicial process with a load which neither the court nor the parties should bear."
>
> *Continental Casualty Co.* v. *American Fidelity & Casualty Co.*, 190 F. Supp. 236, 237 (S.D. Ill. 1959).

We will not examine the licensed patent issue for a third time, and leave undisturbed our previous conclusions.

Consequently, we reach the estoppel issues. Defendants urge that plaintiff is estopped, as a matter of law, from challenging the validity of the 305 patent because plaintiff is a licensee under the 305 patent and/or because plaintiff has marked its products with the 305 patent. Previously, we have found that the 305 patent is a licensed patent right and that plaintiff is a licensee under the 305 patent. Memorandum of June 17, 1968, at 14.

In this area, the general rule is that a licensee under a patent license agreement may not dispute the validity of a patent. *Automatic Radio Manufacturing Co., Inc.* v. *Hazeltine Research, Inc.*, 339 U.S. 827, 836 (1950); *Kinsman* v. *Parkhurst*, 59 U.S. 289, 292-93 (1855); *Bowers Manufacturing Co. Inc.* v. *All-Steel Equipment, Inc.*, 275 F.2d 809, 811 (9th Cir. 1960); *Lehman Co. of America, Inc.* v. *Appleton Toy & Furniture Co.*, 148 F.2d 988, 989 (7th Cir. 1945). See generally, 4 Deller's Walker on Patents, § 403 (2d ed. 1965). Thus, plaintiff may not challenge the validity of the 305 patent on the grounds of statutory non-compliance. Nor may it successfully attack the patent by charging that defendant Offner was guilty of improper conduct in the filing and prosecution of the patent. A licensee who alleged that the patent in question was obtained by fraud on the Patent Office was subject to the doctrine of licensee estoppel. *Borkland* v. *L. A. Goodman Manufacturing Co.*, 95 U.S.P.Q. 387, 388 (1952), 345 Ill. App. 610 (digest of opinion), cert. den., 344 U.S. 921 (1953).

Plaintiff has not responded in any significant way to these points. Rather, relying on *Baldwin Rubber Co.* v. *Paine & Williams Co.*, 107 F.2d 350 (6th Cir. 1939), plaintiff suggests that the licensee estoppel doctrine is inapplicable to situations where the licensee had no opportunity to evaluate the patent. In the first place, the court in *Baldwin* as plaintiff admits, did not expressly rule on the validity of the licensed patent. *Id.* at 354. Moreover, the

court recognized that its holding did "no violence to the rule of estoppel which forecloses challenge by the licensee to the validity of a patent." *Id.* Then, too, in *Automatic Radio Manufacturing Co., Inc.* v. *Hazeltine Research, Inc., supra,* the general licensee estoppel doctrine was applied in a situation where the license agreement covered not only all of the patents which the patentee held, but also those to which it might acquire rights.

Thus, there is no precedent for plaintiff's position. The only exception, of which we are aware, to the doctrine of licensee estoppel is where the license agreement contains a price-fixing agreement. *Id.* at 836; *Borkland* v. *L. A. Goodman Manufacturing Co., supra,* at 388. Plaintiff has not suggested that that exception is applicable here. Consequently, the general rule applies and plaintiff is estopped from challenging the validity of the 305 license.

We believe this discussion is conclusive in and of itself with regard to the estoppel issue. We believe that it is unnecessary to discuss whether plaintiff is also estopped by virtue of the estoppel by marking doctrine.

Finally, plaintiff has alleged that defendants have misused the 305 patent because of the manner in which defendant Offner obtained the patent and because of an alleged course of conduct designed to enlarge the scope of the patent beyond the scope of its claim. As to the first contention, plaintiff is estopped from pursuing this challenge as we have discussed earlier. As to the second point, defendants suggest that the question of the scope of the patent is a subject for arbitration and not the basis for a charge of misuse. Plaintiff has not denied this or even responded to the point. We believe defendant is correct.

Defendants' motion for summary judgment is granted.

Enter:

/s/ Abraham L. Marovitz

.....

Abraham L. Marovitz

Date: April 25, 1969.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1969 — APRIL SESSION, 1970

Nos. 17835, 17836

BECKMAN INSTRUMENTS, INC.,
Plaintiff-Appellant (Cross-Appellee),

v.

TECHNICAL DEVELOPMENT CORPORATION and FRANKLIN F. OFFNER,
Defendants-Appellees (Cross-Appellants).

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division.

September 4, 1970

Before SWYGERT, *Chief Judge*, CUMMINGS and PELL, *Circuit Judges*.

SWYGERT, *Chief Judge*. This appeal presents important issues concerning the doctrines of patent misuse and licensee estoppel. A statement of the facts is necessary before further elaboration and examination of these issues.

Technical Development Corporation is the exclusive licensee of certain patent rights owned by Franklin F. Offner. On August 8, 1961 Technical entered into a "package" sublicense agreement with Beckman Instruments, Inc. The agreement grants Beckman an exclusive sublicense, covering at its inception twenty-one patents and applications and, in addition, certain applications filed by Offner after August 8, 1961 and the patents issued thereon.

The agreement provides that the payment of royalties by Beckman is to be measured by varying percentages of the gross sales price of "Apparatus Subject to Royalties" manufactured by Beckman. Five categories of apparatus are listed. The first four relate to specific types of biochemical electronic apparatus. The fifth includes all apparatus other than those described in the first four categories which are covered by any patent or application sublicensed under the agreement. A ceiling of five million dollars in royalties is stipulated. When payments to Technical reach this ceiling the sublicense becomes fully paid and irrevocable. Unless sooner terminated, the agreement extends to the date when the last sublicensed patent expires. Prior termination of a sublicense of any patent covered by the agreement is permitted if Beckman does not make use of the patent and advises Technical in writing that it has no wish to use such patent or engage in such field of use in the future.

In December 1965 Patent No. 3,225,305 was issued on an application filed by Offner in January 1962 covering an alleged invention of a transistorized differential amplifier. By the terms of the licensing agreement the '305 patent became sublicensed to Beckman. Beckman refused, however, to pay royalties on the apparatus covered by the patent. The refusal precipitated a demand by Technical for arbitration under the terms of the agreement. Beckman thereupon filed its complaint in the instant case, challenging the validity of the '305 patent and the legality of the sublicensing agreement.

The district court granted summary judgment for defendants on Beckman's claim challenging the validity of the '305 patent. The court relied solely upon the doctrine of licensee estoppel. In addition, the district court dismissed Beckman's claim that the sublicense agreement was illegal, holding that the charges of patent misuse failed to state a claim upon which relief could be granted or failed to state an actual controversy. The district court also vacated its prior order staying all judicial proceedings pending com-

pletion of arbitration and entered an order restraining arbitration during the pendency of this appeal. Beckman appeals from the summary judgment with respect to the '305 patent and the dismissal of its claim challenging the legality of the licensing agreement. Defendants cross-appeal from the district court's refusal to stay this proceeding pending arbitration.

We reverse the summary judgment and affirm the refusal to stay this proceeding pending arbitration. The dismissal of plaintiff's challenge to the legality of the sublicense agreement is reversed in part and affirmed in part.

I

In Count I of the complaint, Beckman seeks a declaration of invalidity, noninfringement, and unenforceability with respect to the '305 patent. The plaintiff alleges fraud in the procurement of the patent and also noncompliance with sections 102, 103, and 105, Title 35 of the United States Code.

The district court, relying on the licensee estoppel doctrine, granted defendants' motion for summary judgment. Two months later the Supreme Court overruled this doctrine in *Lear, Inc.* v. *Adkins*, 395 U.S. 653 (1969). Relying on the supremacy of federal patent policy over state contract law, the Court held that the public interest in encouraging challenges to invalid patents requires that licensees be allowed to challenge patent validity and escape payment of royalties. The link between the need for challenge and the remedy of abolishing licensee estoppel was provided by the Court's holding that: "Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification." 395 U.S. at 670.

Defendants attempt to avoid the impact of the *Lear* decision by arguing that the rule announced in that case should

be limited to nonexclusive licenses and that the doctrine of licensee estoppel should still apply to exclusive licensees such as Beckman. It is true that the license involved in *Lear* became nonexclusive prior to the filing of suit, *see* 52 Cal.Rptr. 795, 806 (1966), but nowhere in the Supreme Court's opinion is this fact mentioned. Defendants suggest that this was mere oversight on the part of the Court, and that in fact the basic rationale of *Lear* is inapplicable to exclusive licensees because outsiders also have a strong economic incentive to challenge the monopoly granted the exclusive licensee. In the case of nonexclusive licenses, defendants argue, all would-be competitors are free to become licensees, and henceforth would be barred from challenging the patent unless a limited exception to the doctrine of licensee estoppel were made.

We reject the argument. Even if the failure to distinguish between exclusive and nonexclusive licenses was oversight, we are not convinced that the Supreme Court would rule differently on the facts of this case. Nor can we say that the distinction which the defendants suggest is so great as to require a limitation on the *Lear* rule, especially in light of the "strong federal policy favoring free competition in ideas which do not merit patent protection." *Lear* v. *Adkins, supra* at 656.

Defendants also argue that an exclusive licensee enjoys a monopoly unavailable to a nonexclusive licensee and, having gotten his bargain, should not be allowed to escape royalty payments, especially when the patentee is prevented from licensing to others. But, as plaintiff correctly points out, the whole purpose of this suit is to show that Offner in fact invented nothing and that plaintiff was paying for the use of unpatentable ideas. Moreover, substantially similar arguments as the defendants make were rejected by the Court in *Lear*. There the Court said:

> Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition

> in the use of ideas which are in reality a part of the public domain. . . . We think it plain that the technical requirements of contract doctrine must give way before the demands of the public interest. 395 U.S. at 670.

Defendants' next contention is that the doctrine of estoppel by marking was not necessarily overruled or disapproved by the *Lear* case. Plaintiff concedes that, at Offner's request, it placed the number of the '305 patent on certain of its products during most of the year 1966. Although the district court declined to rule on this point, basing its grant of summary judgment entirely upon the doctrine of license estoppel, we hold as a matter of law that licensees are no longer estopped to challenge the validity of a licensed patent merely because they have marked their products with the patent number.

Defendants attempt to distinguish the doctrines of licensee estoppel and estoppel by marking by suggesting that the former is based on principles of contract law, while the latter has its basis in equity. But defendants' arguments in support of each of these doctrines sound very similar, namely, that it is unfair for licensees to use the patent and accept the benefits of the license and then attack the validity of the patent. However, the Supreme Court in *Lear* rejected such arguments when applied to the licensee estoppel doctrine, and we think the Court's reasoning extends to the doctrine of estoppel by marking as well. Defendants have not suggested any reason why the "strong federal policy" in favor of encouraging challenges to invalid patents should not apply when there has been marking with the patent number. Perhaps it is true that such marking provides the licensee with additional protection from competitors, thus making it seem all the more unfair to allow him to repudiate his obligations. However, it must be noted that the Supreme Court in *Lear* conceded that patent invalidity does not amount to total failure of consideration, but nonetheless held that patent invalidity must

be made a complete defense to the obligation to pay royalties. We cannot say that the additional consideration or "benefit" flowing to the licensee who marks his products with the patent number is sufficient to make the *Lear* case and its policy rationale inapplicable.

II

Count II of the amended complaint charges defendants with five separate forms of patent misuse through various provisions of the sublicensing agreement: first, requiring payment of royalties based on plaintiff's gross sales, including the sale of apparatus not covered by any sublicensed patents; second, requiring that royalties continue until the expiration of the last sublicensed patent; third, preventing Beckman from terminating its obligation under the agreement except by paying royalties aggregating five million dollars or abandoning the fields of biochemical electronics to which it obtained entry through the licensing agreement; fourth, extending coverage, and hence the duration of the agreement, to patents conceived by Offner before the date of the agreement but applied for thereafter; and fifth, fraudulently procuring the '305 patent.

A. *Royalties based on gross sales*

Under the licensing agreement Beckman is obligated to pay royalties on its products if they fall within any of the five categories listed in the agreement under "Apparatus Subject to Royalties." Conceivably, of course, this provision for royalties based on gross sales may cover products which utilize none of the licensed patents. The district court was of the view that such an arrangement, if voluntarily agreed to, was permissible, citing *Automatic Radio Mfg. Co.* v. *Hazeltine Research, Inc.*, 339 U.S. 827 (1950), and therefore concluded that plaintiffs had failed, in this particular, to charge actionable misuse of the licensed patents.

In *Automatic Radio*, a licensing agreement, covering in excess of 570 patents, provided for royalties based on a

percentage of the licensee's selling price of its products regardless of whether any of the patents was used. The Supreme Court said that although convenience may not justify the extension of a patent monopoly, no "inherent" extension was effected under a provision which measures royalty payments by a percentage of the licensee's sales of unpatented as well as patented products. "Sound business judgment could indicate that such payment represents the most convenient method of fixing the business value of the privileges granted by the licensing agreement." 339 U.S. at 834. The Court held that a royalty agreement of this nature was not a per se misuse of the patents.

After the district court's dismissal in the case at bar, the Supreme Court decided *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1969). In *Zenith* the district court had enjoined the patent owner from "conditioning" the grant of a license "upon the paying of royalties on the manufacture, use or sale of apparatus not covered by such patent." The Supreme Court held that such conditioning amounted to patent misuse and that a patent's "leverage" cannot be used "to garner as royalties a percentage share of the licensee's receipts from sales of other products." The Court indicated that *Automatic Radio* was not contrary to this holding and that that decision "is not authority for the proposition that patentees have *carte blanche* authority to condition the grant of patent licenses upon the payment of royalties on unpatented articles." The Court went on to say that, "[i]f convenience of the parties rather than patent power dictates the total-sales royalty provision, there are no misuse of the patents and no forbidden conditions attached to the license."

The defendants contend that absent an allegation that they coerced the plaintiff into agreeing to the royalty provision, there is no showing of misuse. It is true that the complaint does not charge coercion. On the other hand, it does charge patent misuse by requiring royalties "on

apparatus sold by plaintiff regardless of whether such apparatus is covered by any sublicensed patent rights." Notwithstanding the absence of a direct charge of coercion, we believe that the question whether the agreement was one of mutual convenience or was "conditioned" by the patentee should not depend on formalities of pleading. Whether or not Technical was guilty of patent misuse is an issue of fact to be determined at trial. All that is required at this stage is that the defendants have fair notice of the claim asserted. We think that the allegations of the complaint fulfill that requirement. In *Glen Mfg. Inc.* v. *Perfect Fit Industries, Inc.*, 420 F.2d 319 (2d Cir. 1970), patent misuse was charged with respect to a total-sales royalty provision in a licensing agreement. The district court held that the contract amounted to patent misuse, rejecting an application of *Automatic Radio* on the ground that such a royalty device "is an exception to the general rule requiring a strict, limited royalty structure." Subsequent to the district court's decision and before the case reached the court of appeals, the Supreme Court decided *Zenith*. After discussing the holding in *Zenith*, the Second Circuit remanded the case to the district court for further findings on the issue of "conditioning" and for a determination of whether the license agreement amounted to patent misuse under *Zenith*. No concern was evidenced that the case had been tried on issues not framed under *Zenith*. For a stronger reason — because this case has not even been tried -- we think that a similar approach is dictated here.

B. *Royalties until the last patent expires*

The licensing agreement provides that it shall extend to "the date of expiration of the last to expire of the United States Letters Patent included in Licensed Patent Rights." In Count II of its complaint, the plaintiff charges that this provision constitutes patent misuse by extending its royalty obligation for an indefinite and unreasonable period of time and beyond the expiration date of patents

which may cover some of the apparatus manufactured by plaintiffs.

The district court ruled that this provision did not constitute patent misuse, citing in particular *McCullough Tool Co.* v. *Well Surveys, Inc.*, 343 F.2d 381 (10th Cir. 1965), where the court said at page 409:

> The question thus presented is whether a license agreement covering a package of patents, voluntarily entered into by the parties, is unlawful by reason of the fact that the royalties payable thereunder are based upon the licensee's overall operations and upon a package of patents, some of which have expired or will expire during the effective period of the agreement. The validity of such an agreement was upheld by the Supreme Court in *Automatic Radio Mfg. Co.* v. *Hazeltine Research, Inc.*, 339 U.S. 827, 70 S.Ct. 894, 94 Ld. Ed. 1312.

We are in agreement with the Tenth Circuit that a package license agreement, voluntarily entered into, which requires the payment of royalties beyond the expiration of some, but not all, of the licensed patents is valid. However, the question remains whether the licensing agreement in the case before us was voluntarily entered into or was "conditioned" in a manner proscribed by *Zenith*. We perceive no significant distinction between the payment of royalties on apparatus which were never patented and payment of royalties on apparatus on which the licensed patents have expired. When improper conditioning is proved, both arrangements are unjustified attempts to expand the scope of the patent monopoly to cover ideas in the public domain. We do not think that the absence of a charge that this provision was coerced by the defendants is fatal to the claim that the provision constitutes patent misuse. For the reasons heretofore developed in respect to the sufficiency of the allegations concerning the provision for royalties based on gross sales, the plaintiff should be given the opportunity to prove at trial that the provision in question was a condition insisted upon by Technical.

Count II of the complaint also charges that it was a misuse of the licensed patents to include provisions in the agreement which "empower defendants to extend the term of the sublicense agreement and plaintiff's obligations to pay royalties on unpatented products, without plaintiff's consent, by procuring United States Patents on Offner's unfiled inventions at any time subsequent to August 8, 1961, the date of the sublicense agreement." We are unable to see how this provision by itself could constitute patent misuse, even if improper conditioning were shown. As we understand it, there are two elements in a claim of patent misuse under *Zenith*, namely, conditioning and improper extension of the patent monopoly to cover unpatented products. We agree with plaintiff that the inclusion of subsequently filed patents in the license has a tendency to extend the term of the license, and therefore aggravates the other alleged forms of patent misuse involved, *i.e.*, the gross sales royalty and last-patent-to-expire provisions. But, standing alone, it is not an improper extension of the patent monopoly to require royalties based on patents filed for after the license is entered into. We therefore affirm the dismissal as to this claim.

C. *Other patent misuse allegations*

The plaintiff in Count II of its complaint makes the additional charge of patent misuse by referring to those provisions of the agreement which do not permit the plaintiff to terminate "its obligation to pay royalties on unpatented products except by paying to defendant Technical Development Corporation royalties aggregating five million dollars ($5,000,000) or by fully and permanently abandoning the field of biochemical electronics to which plaintiff obtained entree through the sublicense agreement."

Plaintiff argues that these termination provisions are "unreasonably oppressive and anticompetitive." The argument assumes an interpretation of the contract which is unjustified. The five million dollar requirement is merely

a ceiling on the amount of royalties that the plaintiff is required to pay if it continues to manufacture and sell apparatus which use some, but not all, of the sublicensed patents, and even though some of the apparatus does not employ any of the patents. The agreement does not require the payment of a minimum royalty. If no apparatus which is subject to royalties are sold, no royalties are to be paid under the agreement. We are of the view that the five million dollar royalty ceiling provision is entirely independent of the provision which relieves the plaintiff of royalties if, according to terms of the agreement, plaintiff "does not make use of any sublicense granted hereunder . . . and if Beckman further declares in writing . . . that it has no wish in the future to use such patent or claim or to engage in such field. . . ."

Although we are not prepared to stamp with legality that part of the agreement which requires the plaintiff to abandon fields of biochemical apparatus in which it is engaged unless it pays royalties on apparatus regardless of whether it uses the licensed patents, we believe that the district court was correct in dismissing this claim of misuse on the ground that the issue is "hypothetical" and does not present an actual controversy. The court reasoned that the issue is hypothetical unless the plaintiff at least alleges a definite intent to terminate its royalty obligation. We agree. *Wembly, Inc.* v. *Superba Cravats, Inc.*, 315 F.2d 87 (2d Cir. 1963), supports our view. There a would-be patent infringer brought a suit for a declaratory judgment that the patent in question was invalid. The Second Circuit dismissed the suit for lack of jurisdiction under the Declaratory Judgment Act, 28 U.S.C. §2201, saying that, "[w]here there is no actual manufacture, use or sale, and no immediate intention and ability to practice the invention, there is no justiciable controversy." 315 F.2d at 90. Likewise, here the plaintiff has not alleged that it has attempted, or that it definitely intends, to terminate its obligation to pay royalties. In the absence of such allega-

tions, the question of whether the termination provisions of the agreement constitute misuse does not raise an actual controversy between the parties.

Finally, in Count II the plaintiff charges patent misuse by the alleged fraudulent procurement of the '305 patent. Plaintiff cites no case suggesting how this conduct, even if proved, falls within the rule of *Zenith* or any other patent misuse doctrine. We assume, of course, that if the '305 patent is shown to be invalid, it cannot be the basis for royalties, but that does not render the entire licensing agreement an improper attempt to use patent leverage to extend the scope of the patent monopoly.

III

In their cross-appeal, defendants assert that the district court erred in refusing to stay the proceedings pending arbitration under the applicable clause of the licensing agreement.[1] The district court held that the patent validity issue did not fall within the terms of the arbitration clause and that there was no issue ripe for arbitration until the

[1] The arbitration clause reads:

> Any controversy between the parties hereto regarding (1) whether or not certain apparatus sold by Beckman and its subsidiaries falls within the scope of Licensed Patent Rights or Apparatus Subject to Royalty as defined in paragraph 3 hereof or (2) payments made by Beckman to TDC (i) as royalties upon sales of Beckman and its subsidiaries, or (ii) as the share of TDC in royalties paid to Beckman by its sub-licensees, or (iii) as the share of TDC in net amounts realized by Beckman from settlements for past infringement, shall be settled and determined by arbitration in the City of Chicago in accordance with the rules and regulations then obtaining of the American Arbitration Association. Judgment upon the award rendered may be entered in any State or Federal Court of competent jurisdiction for purposes of enforcement.

validity of the '305 patent is determined. We agree. It is evident that the parties did not expressly provide for arbitration of patent validity questions. Moreover, we are in accord with the district court's view that such questions are inappropriate for arbitration proceedings and should be decided by a court of law given the great public interest in challenging invalid patents. *Lear* v. *Adkins*, 395 U.S. 653, 670 (1969). As the district court said: "The complex principles of patent law which a court must consider and apply when deciding issues of validity and infringement, affect important questions of public policy and public rights. In considering the validity of patent claims, a court makes decisions crucial not only to the parties involved, but of vital importance to the public generally."

The defendants argue that even if the complaint did not raise an issue referable to arbitration, there is another dispute between the parties which is arbitrable, namely, that regardless of the validity of the '305 patent some royalties may be payable by virtue of the invention claimed in the patent since the agreement licenses applications for patents as well as the patents themselves. They buttress their argument by referring to section 3 of the Federal Arbitration Act, 9 U.S.C. §3, which provides for mandatory stay of judicial proceedings "[i]f any suit or proceeding be brought in any of the courts of the United States upon *any* issue referable to arbitration under an agreement in writing. . . ." (Emphasis added.) The short answer to this argument is that the claim is not one of the issues raised by plaintiff's complaint; in other words, the royalties under the '305 application are not being challenged by Beckman.

We conclude that the district court properly stayed arbitration until the issues raised by plaintiff's complaint are finally determined.

The judgment of the district court is affirmed in part and reversed in part, and the cause is remanded for further proceedings consistent with this decision.